# HOUSING POLICY STEERING COMMITTEE

**Meeting of April 10, 2007**
**10:00 – 12:00**
**David Gebhard Public Meeting Room**
**630 Garden Street**
**Santa Barbara**

## ISSUES CONCERNING THE CITY OF SANTA BARBARA'S

## INCLUSIONARY HOUSING ORDINANCE

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## ANALYSIS AND RECOMMENDATIONS

**Prepared by:**


**Steven Faulstich**
**Housing Programs Supervisor**
**805-564-5461**


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***Housing Policy Steering Committee Members:***

**Brian Barnwell, City Council Member**

**Iya Falcone, City Council Member**

**Helene Schneider, City Council Member**

**Bruce Bartlett, Planning Commissioner**

**Charmaine Jacobs, Planning Commissioner**

**John Jostes, Planning Commissioner**

## EXECUTIVE SUMMARY

This report presents background information regarding several issues to be addressed in considering possible revisions to the City's Inclusionary Housing Ordinance, which was adopted in 2004. This Ordinance requires that all ownership subdivisions of 10 or more units, whether new construction or condominium conversions, are required to provide 15% of the total units as "inclusionary units." This requirement applies equally to residential zones and commercial zones. Inclusionary units must be sold at prices affordable to middle-income households. Developers are entitled to a density bonus for the inclusionary units.

The Housing Policy Steering Committee, comprising 3 members of the City Council and 3 members of the Planning Commission, has been requested by Council to review and make recommendations about several important housing policy issues, including possible revisions to the Inclusionary Housing Ordinance. The Committee is considering issues such as whether the Inclusionary Ordinance should apply to projects with fewer than 10 units, and whether the inclusionary percentage should be increased from the current 15%.

Staff's recommendations on possible approaches to resolving these issues and improving the Ordinance are summarized in the Conclusions and Recommendations (page 18).

## INTRODUCTION

At the upcoming meeting, the City's Housing Policy Steering Committee will be receiving input from staff and members of the development community and general public on possible changes to the City's Inclusionary Housing Ordinance (IHO). Based on direction from the Committee, staff will then draft recommendations to be presented in a series of public meetings before the City Council, Planning Commission, Ordinance Committee, and finally back to the City Council.

To make the best use of the limited time available at the meeting, staff will distribute this report before the meeting and request that Committee members and interested parties be familiar with it prior to the meeting. This approach will eliminate staff's compulsion to present a long and boring PowerPoint. Instead, staff will present a brief and boring one. The missing boredom will be shifted to the time spent reading this report.

This will be the second meeting of the Housing Policy Steering Committee on this subject of revisions to the IHO. On January 30, 2007, the Committee heard a staff presentation[1] and received input from several speakers. The Committee discussed several issues to be explored in this next meeting, which can be summarized as follows:

1. In the 3 years since the IHO became effective, the in-lieu fee has increased from $310,000 to $475,000. Is that an unreasonable amount? If so, how should the **in-lieu fee formula** be changed?

2. Developers and representatives of the building industry have told the Committee that if the inclusionary requirement is increased too much that many desirable projects will become financially infeasible. What will a spreadsheet model show about the **financial impact** of various inclusionary requirements?

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[1] A copy of the PowerPoint slides from that staff presentation is attached as Appendix D.

3. Should the project size **threshold** to which the IHO applies be lowered from the current 10 units to 5 units or 3 units? And should the percentage inclusionary requirement be **lowered to 10%** for smaller projects (say 3 to 9 units)?
4. Should the required **percentage** of inclusionary units be increased from the current 15%? And, should the inclusionary percentage be **higher for especially large projects** (say 25 units or more)**?**
5. Should the inclusionary percentage be **lower in residential zones than in commercial mixed-use zones?**

There are also some issues that the Committee did not discuss but that staff has noted in administering the IHO:

6. The IHO requires that the developer be given a density bonus incentive for the required inclusionary units as an *entitlement*. Should this entitlement be limited to projects where the **market rate units don't exceed certain specified sizes**?
7. The **minimum unit sizes** for inclusionary units are indeed minimum. Should they be increased to provide more livable space and to reduce the disparity between the inclusionary units and the market units? Also, the requirement for the minimum average **number of bedrooms** in the inclusionary units can sometimes result in a burden on smaller projects. Should the requirement be loosened to provide more flexibility for the bedroom count in the inclusionary units?

That's a hefty list of issues to be resolved in a two hour meeting! Fortunately, this Committee is not charged with crafting the final ordinance revisions, but rather to provide general direction to Council, Planning Commission and Ordinance Committee as the possible revisions continue through the process.

## DISCUSSION: STAFF ANALYSIS OF THE LISTED ISSUES

### 1. IN-LIEU FEES

The Ordinance specifies that the in-lieu fee be calculated as follows:

The monetary difference between:

- The Estimated Production Cost[2] of a 2-bedroom condo unit in the city, and
- The maximum sale price of a 2-bedroom unit affordable to a low income household.

The in-lieu fee was set at a level high enough to encourage on-site construction of the inclusionary units. In some jurisdictions the inclusionary units are rarely built on-site because payment of the in-lieu fee is more attractive financially.

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[2] the Estimated Production Cost is deemed to be 85% of the median sale price of 2-bedroom condos in the City sold in the past year. It assumes that the median sale price is similar to the replacement cost (production cost) of the unit; and, since the Estimated Production Cost does not include developer's profit, the calculation subtracts an estimated developer's profit of 15%... thus the 85% figure.

This table shows the in-lieu fee in 2004 and the fee recalculated with current data.

| | 2004 | 2007 |
|---|---|---|
| Median Sale Price of 2-Bedroom Condo | $500,000 | $689,000 |
| 85% of this | $425,000 | $586,000 |
| Affordable Low-income Unit Price | $115,000 | $111,000[3] |
| **In-Lieu Fee** | **$310,000** | **$475,000** |

So the in-lieu fee has increased by $165,000! Real estate prices in Santa Barbara have skyrocketed in the past 3 years and the in-lieu fee has kept pace. If the Committee believes that the fee has grown to an unrealistic amount, there is a simple change that will bring it down closer to a level we are used to: instead of using the affordable price of a *low-inco*me unit in the calculation, use the price of either an affordable moderate income unit or an affordable *middle income* unit. Here is a comparison of the current calculation method with two pricing alternatives:

| | Current | Alternative Calculation A | Alternative Calculation B |
|---|---|---|---|
| Median Sale Price of 2-Bedroom Condo | $689,000 | $689,000 | $689,000 |
| 85% of this | $586,000 | $586,000 | $586,000 |
| Affordable Low – income Unit Price | $111,000 | - | - |
| Affordable Moderate – income Unit Price | - | $216,000 | - |
| Affordable Middle – income Unit Price | - | - | $269,000 |
| **In-Lieu Fee** | **$475,000** | **$370,000** | **$317,000** |

Staff recommends that the calculation be changed to one of these alternatives. For the sake of analysis staff has use an in-lieu fee of $317,000 in the sections that follow.

[3] The affordable sale price for low income units decreased over the past 3 years due to higher interest rates and higher homeowner association fees. These had more effect on lowering the price than the increase in area median income had in increasing it.

## 2. ANALYSIS OF THE FINANCIAL IMPACT OF VARIOUS INCLUSIONARY REQUIREMENTS

Staff has taken on the task of developing a model (in spreadsheet form) to be used in estimating the financial impact to housing projects of various percentages of inclusionary requirements. This is a challenging task because by its nature it requires many assumptions about land costs, development costs, per square foot sale prices that could be obtained for residential condos and commercial space, and many other factors. Developers will agree that there is no such thing as a typical mixed-use project or a typical condo-only development. So, a model can serve as a rough guide only. Even so, staff found a general consensus among experienced local developers on the most realistic numbers to plug in.

Staff has reviewed various iterations of the draft model with a number of local developers, architects, builders representatives and housing advocates. They have all been very generous in sharing their time and expertise, and staff wishes to express sincere appreciation. They are:

- Jay Blatter, Principal, Hochhauser – Blatter Architects
- Jerry Bunin, Government Affairs Director, Home Builders Association of the Central Coast
- John Campanella, President, Bermant Development Company
- Jan Hochhauser, Principal, Hochhauser – Blatter Architects
- Mickey Flacks, SBCAN
- Detlev Peikert, Principal, Peikert Group Architects
- Rob Pearson, Executive Director, Housing Authority of the City of Santa Barbara
- Lisa Plowman, Planning Manager, Peikert Group Architects
- Skip Szymanski, Chief Operations Officer, Housing Authority of the City of Santa Barbara, and
- Craig Zimmerman, President, the Towbes Group

The bottom line of the financial model in each of the development scenarios is the same "Bottom Line" that developers and homebuilders have mentioned in public comments about the City's IHO. What **percentage profit** are the developers and investors likely to receive if they proceed with the multi-year development process for the project? It is axiomatic in the development and development-investment community that a project will not be pursued unless the financial analysis shows a minimum percentage profit. That minimum profit percentage will vary depending upon several factors, but developers and investors place it between **15% and 20%** of the development cost of the project[4].

[4] Developers point out that this number isn't an annual return but is what will hopefully received at the end of a 4 to 7 year development review and construction process. They also say that it is really more like "profit and overhead" because the investors must be paid a return on their investment and the developers must keep their offices open and staffed during the multi-year

Consultants seem to agree on this range as well. If the financial projections show an estimated profit lower than some number in this range, in most cases the project won't happen.

Besides the assumptions about costs and revenues mentioned above, staff has made another key assumption. That is that in Santa Barbara, in the current climate of development review, there is no assurance that the City's decision makers will allow a project to grow in size, bulk and scale simply because there is an inclusionary requirement imposed. The IHO does provide a density bonus entitlement for the required inclusionary units, but there is no corresponding entitlement to modifications of the City's usual development standards[5].

Because there is no assurance that the developer will receive any modifications to facilitate the increased density, the model assumes that the development envelope (size, bulk and scale) of the project will not be allowed to increase due to the addition of the inclusionary units. Therefore, in the model, <u>the floor area for the required inclusionary units will be subtracted from the floor area of the market rate residential and commercial units</u> that could be built if there were no inclusionary requirement[6].

Actually, it doesn't require a detailed model to show that, under this assumption, an inclusionary requirement will have a significant impact on a project's bottom line. In actual practice, the inclusionary requirement requires that the developer trade *market rate floor area* that would sell for between $600 and $850 per square foot for *affordable housing floor area* that will sell for about $270 per square foot[7]. Since the development

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process. The higher the risk and uncertainty and the longer the estimated development process, the higher the minimum estimated profit required to make the risk worthwhile. Developers remember that the market can turn, and many have lost money on projects that didn't pan out as projected.

[5] The IHO says this: "28.43.050.B. Use of Zoning Ordinance Modifications. The City ***may*** provide modifications in zoning requirements that will facilitate increased density for the purpose of accomplishing the goals of this Chapter, including modifications to parking, setback, yard area, lot area, open space and solar access requirements… (emphasis added)."

[6] The developer may submit a design with increased size and bulk to accommodate the inclusionary units while maintaining large market-rate units, but the model assumes that the average size of the market rate units will be reduced during the development review process to arrive at an acceptable size and bulk.

[7] The picture would change dramatically if the developer were assured that the required inclusionary units would not result in the floor area of the market rate units being reduced during the development review process. The City could amend the IHO to require that some development incentives be approved as an entitlement to assure that the project can accommodate the density bonus units that are allowed as an entitlement. This is the approach that the State took in the recently amended state density bonus law. But it is unlikely that the City Council would approve this across-the-board for all projects. The mood of the public and of the City's decision makers appears to favor approval of projects with less, rather than more, size, bulk and scale, especially in the El Pueblo Viejo area.

cost for the affordable units isn't much less than that of market rate units, and the affordable housing requires additional parking as well, the project will receive *at least* $400 per square foot less for the floor area required for affordable housing. For a 1,000 square foot two bedroom middle income unit, that's a $400,000 loss of revenue. In many cases it might make more financial sense for the developer to pay an in-lieu fee of $317,000. With an in-lieu fee of $370,00 the developers would most likely build the units on-site.

On the next 3 pages are summaries of the financial models of 3 project types (mixed-use outside the Central Business District, mixed-use in the CBD (which is subject to a reduction in required parking), and a 7-unit condo project in a residential zone). They compare the percentage profit that these example projects might yield if there is no inclusionary requirement and if there are inclusionary requirements of various percentages[8]. The spreadsheet financial models are attached as Appendices A, B and C.

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[8]As noted above, these models are just rough guides to the impact of various inclusionary requirements, and they could benefit from further refinements. For example, one expert pointed out that the financial impact of added inclusionary units is somewhat understated because a fixed sale price per square foot is shown across all project densities. In fact, the market units become less desirable as more units are added, so it would be more accurate to reduce the projected sale price per square foot as density increases.

**Scenario A - Mixed Use Project Outside the Central Business District:**
Assumptions in this Scenario:

- 35,500 square foot lot zoned C-2, with
- 15 dwelling units allowed under variable density
  - 3 one-bedroom units - average net floor area = 1,200 sq. ft.
  - 6 two-bedroom units - average net floor area = 2,200 sq. ft.
  - 6 three-bedroom units - average net floor area = 2,533 sq. ft.
- 15,000 square feet of commercial space.
- 30 required parking spaces for the residential and 60 for the commercial, provided in a below-grade structure taking nearly all of the lot area.
- Because of limitations on the project's size, bulk and scale, the floor area of the required inclusionary units will be deducted from the floor area of the market rate residential units.
- Also, to provide 2 parking spaces for each inclusionary unit, 500 square feet will be deducted from the commercial floor area so that the parking requirement of the commercial area is reduced by two spaces.
- The space deducted from the commercial floor area will free up additional room for the residential units, so this can be added back to the residential floor area.
- The market rate units are projected to sell for about $700 per square foot

| Summary of the Financial Impact of Different Inclusionary Requirements Scenario A | | | | | |
|---|---|---|---|---|---|
| Inclusionary Requirement | Inclusion-ary Units | Floor Area of Market Units | Comm'l Floor Area | % Profit If Units Built On-Site | % Profit (If In-Lieu Fee of $317,000 per Unit is Paid |
| None | 0 | 32,000 | 15,000 | 17.8% | |
| 15% | 2 | 29,700 | 14,000 | 13.0% | 15.4% |
| 20% | 3 | 28,700 | 13,500 | 10.8% | 14.1% |
| 25% | 4 | 27,700 | 13,000 | 8.7% | 12.9% |
| 30% | 5 | 26,700 | 12,500 | 6.5% | 11.7% |

This Scenario A shows that a 15% inclusionary requirement has a substantial effect on the project's bottom line. The developer would probably choose to pay the in-lieu fee. Increasing the required inclusionary percentage to 20% would send the profit slightly below the 15% minimum profit that developers and investors seek. A 25% or 30% inclusionary requirement would make the project infeasible.

**Scenario B - Mixed Use Project in the Central Business District:**

Assumptions in this Scenario:

The following assumptions are the same as Scenario A:

- 35,500 square foot lot zoned C-2, with
- 15 dwelling units allowed under variable density
  - 3 one-bedroom units - average net floor area = 1,200 sq. ft.
  - 6 two-bedroom units - average net floor area = 2,200 sq. ft.
  - 6 three-bedroom units - average net floor area = 2,533 sq. ft.
- 15,000 square feet of commercial space.
- Because of limitations on the project's size, bulk and scale, the floor area of the required inclusionary units will be deducted from the floor area of the market rate residential units.

The following assumptions differ from Scenario A:

- 15 required parking spaces for the residential plus 15 spaces provided to meet market demand (developers state that two reserved parking spaces are necessary for each market-rate unit in the targeted price range), and 30 for the commercial instead of 60 (although this could be less than 30 in a parking zone of benefit).
- For each inclusionary unit, 300 square feet of floor area will be deducted to make room for the 1 required parking space per additional residential unit.
- The market rate units are projected to sell for about $825 per square foot. This is higher than used in the previous scenario for units outside the Central Business District because these downtown locations are in higher demand. Also, a higher construction cost was used because these units would have more costly finishes and private garages and private elevators.

| Summary of the Financial Impact of Different Inclusionary Requirements Scenario B | | | | | |
|---|---|---|---|---|---|
| Inclusionary Requirement | Inclusion-ary Units | Floor area of Market Units | Comm'l Floor Area | % Profit If Units are Built On-Site | % Profit (If In-Lieu Fee of $317,000 per Unit is Paid |
| None | 0 | 32,000 | 15,000 | 19.6% | |
| 15% | 2 | 29,700 | 14,400 | 14.8% | 17.3% |
| 20% | 3 | 28,700 | 14,100 | 12.6% | 16.2% |
| 25% | 4 | 27,700 | 13,800 | 10.6% | 15.1% |
| 30% | 5 | 26,700 | 13,500 | 8.6% | 14.0% |

This Scenario B shows that even a 15% inclusionary requirement has a substantial effect on the project's bottom line, and the project would be borderline. Increasing the required inclusionary percentage to 20% might make it infeasible to build the units on-site. The developer may choose to pay the in-lieu fee instead.

**Scenario C – Seven Condos on R-3 Lot**
Assumptions in this Scenario:

- 17,000 square foot lot zoned R-3.
- Seven condo units are allowed under variable density
- 2 one-bedroom units - average net floor area = 925 sq. ft.
- 2 two-bedroom units - average net floor area = 1,475 sq. ft.
- 3 three-bedroom units - average net floor area = 1,900 sq. ft.
- Two parking spaces per unit in a private garage.
- The floor area of the required inclusionary units plus 400 square feet for required parking will be deducted from the floor area of the market rate residential units.
- The market rate units will sell for about $750 per square foot

| Summary of the Financial Impact of Different Inclusionary Requirements Scenario C | | | | |
|---|---|---|---|---|
| Inclusionary Requirement | Inclusionary Units | Floor area of Market Units | % Profit If Unit is Built On-Site | % Profit (If In-Lieu Fee of $221,900 is Paid (70% of $317,000) |
| None | 0 | 10,500 | 16.5% | - |
| 10% | 0.7 | 9,100 | 7.8% | 13.0% |

With a project of this small size it would most likely be impossible to fit another unit and another 2 parking spaces into the project without making the remaining units too small or the project too large in size and bulk. Even if it could be done, the bottom line would become infeasible. The in-lieu fee is the only real option. Note that a 10% inclusionary requirement for projects below ten units would result in the requirement for a fraction of a unit. This fraction would be applied to the in-lieu fee. Ten percent of 7 units is 0.7, or 70%. Seventy percent of $317,000 would result in an in-lieu fee of $222,000 in this case. That would be an impact on the bottom line, but not nearly as great as building the unit on-site.

A summary of the results of these 3 scenarios appears on the next page.

**Summary of Scenarios A, B and C – Financial Impact of Various Inclusionary Requirements:**

**Scenario A –** 15 unit mixed-use outside the Central Business District

| | |
|---|---|
| 15% | Feasible |
| 20% | Borderline Feasible if in-lieu fee paid |
| 25% | Not Feasible |
| 30% | Not Feasible |

**Scenario B –** 15 unit mixed-use in the Central Business District

| | |
|---|---|
| 15% | Feasible |
| 20% | Feasible |
| 25% | Borderline Feasible if in-lieu fee paid |
| 30% | Not Feasible |

**Scenario C –** 7 new condos on R-3 lot

| | |
|---|---|
| 10% – unit built on site | Not Feasible |
| 10% - in-lieu fee paid | Borderline Feasible |

## 3. THRESHOLD NUMBER OF UNITS

The current ordinance does not apply to projects smaller than ten units. Some Councilmembers and members of the public advocated at the time for a lower threshold, but others expressed concern that smaller projects would not be able to fit an additional unit on the site.

However, it has become clear that the majority of ownership housing projects, both new construction and condominium conversions, have fewer than ten units. Staff counted 12 approved ownership projects with between 5 and 9 units that were approved in the 3 years since the ordinance was adopted. Also, the pace of conversion of apartments to condos seems to be brisk. The IHO contains findings that there is a need for housing that is affordable to a broad range of incomes and that new housing increases demand for services provided by people who cannot afford housing in the City. These findings are applicable to smaller as well as larger new housing projects and condo conversions.

A concern with any threshold is that it may create a built-in incentive for projects just at the threshold to reduce the number of units to below the threshold to avoid the inclusionary requirement. With the current threshold of ten units, a developer on a site zoned for ten units would have a 2-unit inclusionary requirement for ten units but none for a 9 unit project. Likewise, a developer converting a ten-unit apartment building to condos would realize more profit by reconfiguring to 9 condos. That same situation may occur if the threshold were lowered to 5 units. This might encourage 4 larger units rather than 5 smaller ones.

In response to comments from the Committee at the last meeting, and with the above considerations in mind, staff has prepared the following recommendations for consideration:

- To extend the inclusionary requirement to more condo conversion and small construction projects, and to minimize the incentive for smaller projects and larger units, **lower the threshold from 10 units to 3 units**
- **Reduce the inclusionary percentage for projects of 3 to 9 units** to 10% in all zones. As an alternative, apply an inclusionary requirement of 15% in commercial zones and reduce it to 10% in residential zones for projects of 3 to 9 units.
- To reduce the chance that projects will be incompatible with their neighborhoods, do not extend an entitlement to a **density bonus for inclusionary units in projects of 3 to 9 units in.** The Planning Commission could still approve a density bonus, but it would be discretionary. As an alternative, provide an entitlement to a density bonus, but only for projects in which the average size of the market rate units does not exceed some threshold to be specified in the IHO. This is explored further in section 6 below.
- Continue to **apply a pro-rated in-lieu fee** for inclusionary requirements that result in a fraction of a unit, and expect that many projects between 3 and 9 units will meet the inclusionary requirement by paying the pro-rated in-lieu fee.

The following table shows the amount of in-lieu fee required for various project sizes with a 3 units threshold and a 10% inclusionary requirement. The pro-rated in-lieu fee would be 10% of the full in-lieu fee for each market rate unit in the project.

| In-Lieu Fee for 3 to 9 Units<br>Based on **10%** Inclusionary Requirement | | | |
|---|---|---|---|
| Number of Units in Project | Percent of In-Lieu Fee Required | Pro-Rated In-Lieu Fee (based on a full fee of $370,000) | Pro-Rated In-Lieu Fee (based on a full fee of $317,000) |
| 3 | 30% | $111,000 | $95,100 |
| 4 | 40% | $148,000 | $126,800 |
| 5 | 50% | $185,000 | $158,500 |
| 6 | 60% | $222,000 | $190,200 |
| 7 | 70% | $259,000 | $221,900 |
| 8 | 80% | $296,000 | $253,600 |
| 9 | 90% | $333,000 | $285,300 |

If a 15% inclusionary requirement is set for 3-9 units in commercial zones, the pro-rated in-lieu fee would be 15% of the full in-lieu fee for each market rate unit in the project.

| In-Lieu Fee for 3 to 9 Units<br>Based on **15%** Inclusionary Requirement | | | |
|---|---|---|---|
| Number of Units in Project | Percent of In-Lieu Fee Required | Pro-Rated In-Lieu Fee (based on a full fee of $370,000) | Pro-Rated In-Lieu Fee (based on a full fee of $317,000) |
| 3 | 45% | $166,500 | $142,650 |
| 4 | 60% | $222,000 | $190,200 |
| 5 | 75% | $277,500 | $237,750 |
| 6 | 90% | $333,000 | $285,300 |
| 7 | 105% | $388,500 | $332,850 |
| 8 | 120% | $444,000 | $380,400 |
| 9 | 135% | $499,500 | $427,950 |

## 4. PERCENTAGE INCLUSIONARY REQUIREMENT

Should the required **percentage** of Inclusionary units be increased from the current 15%? And, should the inclusionary percentage be **higher for especially large projects** (say 25 units or more)?

These choices comes down to a balancing of the public benefit from additional inclusionary units with the financial impact to projects. The financial models discussed in Section 2 demonstrate that increasing the inclusionary requirement will result in an impact to the bottom line of housing projects. At some level of inclusionary requirement the burden will become so great that projects will not happen and no inclusionary units will be generated. At such a level the inclusionary requirement would become, in practice, a moratorium on housing projects rather than a tool for assuring the creation of middle income affordable housing.

On the following pages are several tables showing the number of inclusionary units that would be required by various inclusionary percentages. Some tables show a higher inclusionary percentage for larger projects. Some show a lower inclusionary requirement for projects in residential only zones than in commercial mixed-use zones. Staff suggests that the Committee use these tables as a guide to selecting, and recommending, either

- a fixed inclusionary percentage for all projects (like the current IHO), or
- a set of inclusionary percentages that would vary by project size and perhaps by residential vs. commercial zones.

| Inclusionary Percentages Compared | | | | |
|---|---|---|---|---|
| Units in Project | **15%** | **20%** | **25%** | **30%** |
| 10 | 2 | 2 | 3 | 3 |
| 11 | 2 | 2 | 3 | 3 |
| 12 | 2 | 2 | 3 | 4 |
| 13 | 2 | 3 | 3 | 4 |
| 14 | 2 | 3 | 4 | 4 |
| **15** | **2** | **3** | **4** | **5** |
| 16 | 2 | 3 | 4 | 5 |
| 17 | 3 | 3 | 4 | 5 |
| 18 | 3 | 4 | 5 | 5 |
| 19 | 3 | 4 | 5 | 6 |
| **20** | **3** | **4** | **5** | **6** |
| 21 | 3 | 4 | 5 | 6 |
| 22 | 3 | 4 | 6 | 7 |
| 23 | 3 | 5 | 6 | 7 |
| 24 | 4 | 5 | 6 | 7 |
| **25** | **4** | **5** | **6** | **8** |
| 26 | 4 | 5 | 7 | 8 |
| 27 | 4 | 5 | 7 | 8 |
| 28 | 4 | 6 | 7 | 8 |
| 29 | 4 | 6 | 7 | 9 |
| **30** | **5** | **6** | **8** | **9** |
| 31 | 5 | 6 | 8 | 9 |
| 32 | 5 | 6 | 8 | 10 |
| 33 | 5 | 7 | 8 | 10 |
| 34 | 5 | 7 | 9 | 10 |
| **35** | **5** | **7** | **9** | **11** |

**Large Projects:** Because some economies of scale apply to large developments (say 25 units or more), there may be less of a financial impact of a higher inclusionary requirement for these projects. For example, a significant percentage of a project's costs are for soft costs such as architecture, engineering, financing, sales etc., and these costs do not increase proportionally with the size of the project. However, without financial models and developer feedback, such economies of scale are difficult to estimate. Example #1 below shows an inclusionary requirement of 20% for all projects of 10 units or more, and Example #2 shows the requirement increasing to 25% for projects with 25 or more units.

| **Example # 1**<br>20% for all projects over 10 units | | |
|---|---|---|
| Units in Project | % | # Inclus. Units |
| 3 | 10% | 0.3 |
| 4 | | 0.4 |
| 5 | | 0.5 |
| 6 | | 0.6 |
| 7 | | 0.7 |
| 8 | | 0.8 |
| 9 | | 0.9 |
| 10 | 20% | 2 |
| 11 | | 2 |
| 12 | | 2 |
| 13 | | 3 |
| 14 | | 3 |
| 15 | | 3 |
| 16 | | 3 |
| 17 | | 3 |
| 18 | | 4 |
| 19 | | 4 |
| 20 | | 4 |
| 21 | | 4 |
| 22 | | 4 |
| 23 | | 5 |
| 24 | | 5 |
| 25 | | 5 |
| 26 | | 5 |
| 27 | | 5 |
| 28 | | 6 |
| 29 | | 6 |
| 30 | | 6 |
| 31 | | 6 |
| 32 | | 6 |
| 33 | | 7 |
| 34 | | 7 |
| 35 | | 7 |

| **Example # 2**<br>20% for 10 – 24 units<br>25% for 25 or more units | | |
|---|---|---|
| Units in Project | % | # Inclus. Units |
| 3 | 10% | 0.3 |
| 4 | | 0.4 |
| 5 | | 0.5 |
| 6 | | 0.6 |
| 7 | | 0.7 |
| 8 | | 0.8 |
| 9 | | 0.9 |
| 10 | 20% | 2 |
| 11 | | 2 |
| 12 | | 2 |
| 13 | | 3 |
| 14 | | 3 |
| 15 | | 3 |
| 16 | | 3 |
| 17 | | 3 |
| 18 | | 4 |
| 19 | | 4 |
| 20 | | 4 |
| 21 | | 4 |
| 22 | | 4 |
| 23 | | 5 |
| 24 | | 5 |
| 25 | 25% | 6 |
| 26 | | 7 |
| 27 | | 7 |
| 28 | | 7 |
| 29 | | 7 |
| 30 | | 8 |
| 31 | | 8 |
| 32 | | 8 |
| 33 | | 8 |
| 34 | | 9 |
| 35 | | 9 |

## 5. RESIDENTIAL VS. COMMERCIAL ZONES

Should the inclusionary percentage be **lower in residential-only zones than in commercial mixed-use zones**?

New construction projects in residential zones may face some challenges not faced by mixed-use projects in commercial zones. Neighbors in residential zones may be more sensitive to density increases than neighbors in commercial zones. It may be more difficult to fit additional required parking on residential sites because they typically have above-grade parking and no right to share parking with commercial space on site. Granting an entitlement to a density bonus for a higher number of inclusionary units may result in projects that are less than ideal for their location. For these reasons, the Committee may wish to consider reducing the inclusionary requirement in residential zones.

| Example #3 Commercial Zones | | |
|---|---|---|
| Units in Project | % | # Inclus. Units |
| 3 | 15% | 0.5 |
| 4 | | 0.6 |
| 5 | | 0.8 |
| 6 | | 0.9 |
| 7 | | 1.1 |
| 8 | | 1.2 |
| 9 | | 1.4 |
| 10 | 20% | 2 |
| 11 | | 2 |
| 12 | | 2 |
| 13 | | 3 |
| 14 | | 3 |
| 15 | | 3 |
| 16 | | 3 |
| 17 | | 3 |
| 18 | | 4 |
| 19 | | 4 |
| 20 | | 4 |
| 21 | | 4 |
| 22 | | 4 |
| 23 | | 5 |
| 24 | | 5 |
| 25 | 25% | 6 |
| 26 | | 7 |
| 27 | | 7 |
| 28 | | 7 |

| Example #4 Residential Zones | | |
|---|---|---|
| Units in Project | % | # Inclus. Units |
| 3 | 10% | 0.3 |
| 4 | | 0.4 |
| 5 | | 0.5 |
| 6 | | 0.6 |
| 7 | | 0.7 |
| 8 | | 0.8 |
| 9 | | 0.9 |
| 10 | 15% | 2 |
| 11 | | 2 |
| 12 | | 2 |
| 13 | | 2 |
| 14 | | 2 |
| 15 | | 2 |
| 16 | | 2 |
| 17 | | 3 |
| 18 | | 3 |
| 19 | | 3 |
| 20 | | 3 |
| 21 | | 3 |
| 22 | | 3 |
| 23 | | 3 |
| 24 | | 4 |
| 25 | 20% | 5 |
| 26 | | 5 |
| 27 | | 5 |
| 28 | | 6 |

## 6. DENSITY BONUS INCENTIVE

The IHO currently entitles an applicant to a density bonus as an incentive for providing required inclusionary units on-site. The density bonus is equal to the number of required inclusionary units that are provided on-site. This guarantee was key to getting support from the development community for the current IHO. For example, a project zoned for 10 units is *entitled* to a density bonus for the 2 required inclusionary units. It follows that such a project is also entitled to develop the entire "base density" allowed by the zoning. However, projects are still subject to review of the size, bulk and scale of the proposed design. At times the bonus density incentive may contribute to a project having an inappropriate size, bulk or scale. If the size of a proposed project is not appropriate for the location, the review bodies may require a reduction in the size of the market rate units, or a reduction in the size of the commercial floor area, or a reduction in the size of the plate heights, but reducing the number of market rate or density bonus units is a more complicated matter in light of the bonus density incentive.

Should this "density bonus incentive" apply to all projects, no matter how large the market rate units are? It seems reasonable that a condominium or mixed-use project that proposes very large market rate units (say, units that average over 2,500 square feet) would be subject to size reductions imposed during the development review process. If the developer is sent back to reduce the size of the units but returns with a project that is still too large, shouldn't the discretionary review bodies have the discretion to require a reduction in the number of units? If this discretion is intended, the IHO density bonus incentive should be revised.

On the other hand, if the sizes of the market rate units are not excessive, shouldn't the developer be able to rely on receiving the full density bonus incentive as specified in the IHO?

Staff recommends that the Committee consider a revised IHO policy on density bonus for inclusionary units; it would provide that:

- Projects with very large market rate units would *not be entitled* to a density bonus incentive for the inclusionary units. Rather, the granting of a density bonus would be *discretionary*. If the Planning Commission denies the density bonus for the inclusionary units, the applicant could either provide the units within the base density or pay the in-lieu fee (or even a combination of the two).
- Projects with market rate units that do not exceed specified "safe harbor" floor areas <u>would</u> be entitled to a density bonus incentive for the inclusionary units. These projects would be deemed to met the lot area requirements, and *no lot area modification would be required*.

- The maximum average size threshold for units in projects qualifying for this would be defined in the IHO. For purposes of discussion, the following average net square feet size limits might be appropriate[9]:
  - 1 bedroom 1,400 net sq. ft.
  - 2 bedroom 1,900
  - 3 bedroom 2,300

These are per unit averages, not per unit maximums. For example, the maximum "safe harbor" net square footage of a 15-unit project with 5 units each of 1, 2 and 3 bedrooms would be (5 x 1,400) + (5 x 1,900) + (5 x 2,300) = 28,000 sq. ft. The developer could distribute this among the units in any amounts. In this example, the project would meet the test if the 1 bedroom units were 1,200 sq. ft., the 2 bedroom units were 1700 sq. ft. and the 3 bedroom units were 2,700 sq. ft.

This is likely to be a controversial proposal. Some developers state that the demand from their prospective buyers is for very large units. Such buyers are often people selling a single-family home and moving into an urban condominium setting; they want space for their furniture and for entertaining. Developers may feel that removing the density bonus entitlement for projects with large units will make the inclusionary requirement unworkable, especially if the required inclusionary percentage is increased.

**Staff requests a recommendation from the Committee on whether this idea should be referred to the full Council and Planning Commission for discussion.**

## 7. MINIMUM UNITS SIZES AND MINIMUM BEDROOM COUNT

The **minimum unit sizes** for inclusionary units are indeed minimum. They were established twenty years ago and were applied mostly to moderate income units developed by non-profit sponsors. In most cases the inclusionary units provided under the ordinance have been much larger than these minimums. In a few projects the inclusionary units were designed to just meet the minimum sizes, and these seemed cramped and inadequate (especially in contrast to the generous sizes of the market rate units).

Staff recommends that the minimum unit size for middle income inclusionary units be increased to provide more livable space and to reduce the disparity between the inclusionary units and the market units. This table shows the current and the recommended new minimum sizes in net square feet:

[9] Planning Commission has recently applied a rule of thumb for unit sizes based on 85% of the minimum lot area for units in variable density zones. Applying this rule of thumb would result in the following maximum "safe harbor" unit sizes: 1 bedroom = 1,564 net sq. ft.; 2 bedroom = 1,972; 3 bedroom = 2,380.

| Minimum Sizes of Inclusionary Units (Net Sq. Ft.) | | |
|---|---|---|
| Bedroom Count | Current Minimum | Recommended New Minimum |
| Studio | 450 | 600 |
| 1 Bedroom | 600 | 750 |
| 2 Bedroom | 850 | 1,000 |
| 3 Bedroom | 1,100 | 1,250 |

The **minimum bedroom count for inclusionary units** under the IHO is set as follows:

> "The average number of bedrooms in the inclusionary units must equal or exceed the average number of bedrooms in the market rate units."

This was well intentioned, but has had some unexpectedly inflexible results in practice. For example, a project with 11 two-bedroom units and 1 three-bedroom unit would have an average of 2.08 bedrooms, so the IHO would require that 1 of the 2 inclusionary units be a three-bedroom unit. Staff thinks that it would be sufficient if the inclusionary units were both two-bedroom units.

Staff recommends that the ratio requirement be changed to provide more flexibility. For example, "The average number of bedrooms in the inclusionary units must be at least 95% of the average number of bedrooms in the market rate units." That test would be met by 2 two-bedroom units in the above example. Staff will refine this recommendation as the ordinance revisions proceed through the process.

## CONCLUSION AND RECOMMENDATIONS:

### 1. IN-LIEU FEES

The current in-lieu fee formula results in a fee of $475,000. This is a large increase since 2004 when the fee was $310,000. Staff recommends that the formula be revised according to either alternative A or alternative B as described on page 3. Under the proposed new methods of calculation, the approximate new would be either $370,000 or $317,000. These fee will likely be high enough to encourage construction of the inclusionary units on-site, especially the higher alternative. If the in-lieu fee is paid, it will be used to supplement diminishing affordable housing subsidy funds to assist new low-income rental projects in the City.

### 2. ANALYSIS OF THE FINANCIAL IMPACT OF VARIOUS INCLUSIONARY REQUIREMENTS

Under the financial model developed by staff and reviewed by several local developers, architects and housing advocates, it appears that increasing the inclusionary requirement to 20% would be workable for projects in mixed-use zones, but increasing it to 30% would make the projects financially infeasible. Of course, if the project is not built, no inclusionary units will result. *Staff recommends against a 30% inclusionary requirement.*

For projects of between 3 and 9 units in residential zones, a 10% inclusionary requirement would have a substantial impact on the project finances, but such projects may still be feasible if they pay a pro-rated in-lieu fee. Building the inclusionary unit on-site, even with a density bonus, would appear to make such projects infeasible.

Here is the summary of the financial models (copied from page 10):

**Scenario A –** 15 unit mixed-use outside the Central Business District

| | |
|---|---|
| 15% | Feasible |
| 20% | Borderline Feasible if in-lieu fee paid |
| 25% | Not Feasible |
| 30% | Not Feasible |

**Scenario B –** 15 unit mixed-use in the Central Business District

| | |
|---|---|
| 15% | Feasible |
| 20% | Feasible |
| 25% | Borderline Feasible if in-lieu fee paid |
| 30% | Not Feasible |

**Scenario C** – 7 new condos on R-3 lot

| | |
|---|---|
| 10% – unit built on site | Not Feasible |
| 10% - in-lieu fee paid | Borderline Feasible |

## 3. THRESHOLD NUMBER OF UNITS

Staff recommends that inclusionary requirement be expanded to apply to subdivisions of 3 or more units (or, in the case of lot splits and bare land subdivisions, 3 or more lots), rather than the current threshold of 10 units. Staff recommend that a 10% inclusionary requirement apply to project of 3 through 9 units in residential zones. In Commercial mixed-use zones, the Committee should consider either a 10% or 15% requirement.

## 4. INCLUSIONARY REQUIREMENT – COMMERCIAL ZONES

Staff recommends:

| | | |
|---|---|---|
| Projects with | 3-9 units – | 10% or 15% |
| | 10 – 24 units - | 20% |
| | 25 and over | 20% or 25% |

## 5. INCLUSIONARY REQUIREMENT – RESIDENTIAL ZONES

Staff recommends:

| | | |
|---|---|---|
| Projects with | 3-9 units – | 10% |
| | 10 – 24 units - | 15% or 20% |
| | 25 and over | 20% or 25% |

## 6. DENSITY BONUS INCENTIVE FOR THE REQUIRED INCLUSIONARY UNITS

For project with under 10 units:

- A density bonus incentive for the required inclusionary units should be discretionary rather than an entitlement.
- Staff expects that most projects under 10 units will meet their inclusionary requirement by paying a fractional in-lieu fee.

For projects of 10 or more units:

- A density bonus incentive for the required inclusionary units in projects with market rate units that do not exceed specified “safe harbor” floor areas (to be defined) should be an entitlement. These projects would be deemed to met the lot area requirements, and *no lot area modification would be required*.
    - the following average net square feet size limits might be appropriate:
        - 1 bedroom 1,400 net sq. ft.
        - 2 bedroom 1,900
        - 3 bedroom 2,300
- A density bonus incentive will be *discretionary* for the required inclusionary units in projects with larger market rate units. For these projects, a lot area modification will be required if a density bonus is approved.

## 7. MINIMUM UNITS SIZES AND MINIMUM BEDROOM COUNT

Staff recommends the following minimum sizes for inclusionary units:

| | |
|---|---|
| Studio | 600 net sq. ft. |
| 1 Bedroom | 750 |
| 2 bedroom | 1,000 |
| 3 bedroom | 1,250 |

Staff also recommends that the method of setting the minimum average bedroom count for inclusionary units be revised to provide more flexibility.

The following pages show the decision matrix to be discussed and completed by Committee members at the April 10th meeting.

# Decision Matrix - Revisions to Inclusionary Ordinance

## In-Lieu Fee

| | $370,000 | $317,000 |
|---|---|---|
| Revise formula to lower from $475,000 to either $370,000 or $317,000? | ☐ | ☐ |

## Minimum Number of Units to which IHO Applies (Threshold)

| | 3 | 5 | 10 |
|---|---|---|---|
| Apply to this many units or more: | ☐ | ☐ | ☐ |

## Commercial Zones – Inclusionary Percentage

| | 10% | 15% |
|---|---|---|
| 3-9 (or 5-9) units: | ☐ | ☐ |

| | 15% | 20% | 25% | 30% |
|---|---|---|---|---|
| 10-24 units: | ☐ | ☐ | ☐ | ☐ |
| 25 or more units: | ☐ | ☐ | ☐ | ☐ |

## Residential Zones – Inclusionary Percentage

| | 10% | 15% |
|---|---|---|
| 3-9 (or 5-9) units: | ☐ | ☐ |

| | 15% | 20% | 25% | 30% |
|---|---|---|---|---|
| 10-24 units: | ☐ | ☐ | ☐ | ☐ |
| 25 or more units: | ☐ | ☐ | ☐ | ☐ |

**Density Bonus for Incentive for Inclusionary Units**
***Projects Under 10 Units***

Please choose one of the following:

A. To reduce the chance that projects will be incompatible with their neighborhoods, do not apply a density bonus incentive as an entitlement for inclusionary units in projects of 3 to 9 units. Expect payment of in-lieu fee for these smaller projects.

**A** ☐

B. Provide a density bonus incentive as an entitlement for projects with market rate units that do not exceed specified “safe harbor” floor areas (to be defined). These projects would be deemed to met the lot area requirements, and no lot area modification would be required. A density bonus incentive will be discretionary for projects with larger market rate units.

**B** ☐

C. Because density bonus may be more difficult to accommodate in residential zones, apply choice "A" to residential zones and choice "B" to commercial zones

**C** ☐

**Density Bonus for Incentive for Inclusionary Units**
***Projects with 10 or More Units***

Please choose one of the following:

A. No change. Planning Commission must approve entire base density plus a density bonus for all inclusionary units. If PC deems the project is too large, PC may require smaller units or less commercial space but may not require a reduction in the number of units.

**A** ☐

B. Revise policy. A density bonus incentive will still be an entitlement for projects with market rate units that do not exceed specified “safe harbor” floor areas (to be defined). Density bonus will be discretionary for projects with larger market rate units.

**B** ☐

## Minimum Unit Sizes for Inclusionary Units

A. No Change **A** ☐

B. Increase minimum unit sizes for inclusionary units to the following: **B** ☐

| | | |
|---|---|---|
| Studio | 600 | net sq. ft. |
| 1 Bedroom | 750 | net sq. ft. |
| 2 Bedroom | 1,000 | net sq. ft. |
| 3 Bedroom | 1,250 | net sq. ft. |

## Minimum Average Number of Bedrooms for Inclusionary Units

A. No Change **A** ☐

B. Revise the requirement to provide more flexibility. **B** ☐